

OVERSIGHT BOARD AGENDA STAFF REPORT

TO: Honorable Chair and Members of the Oversight Board

FROM: Francesca Tucker-Schuyler, Successor Agency Executive Director
BY: Christopher Cardinale, Successor Agency Legal Counsel

SUBJECT: State Controller Audit and Successor Agency Request for Oversight Board Approval of Specified Redevelopment Agency Transactions

DATE: November 13, 2013

OBJECTIVE

Obtain Oversight Board approval for asset transfers between the former Community Redevelopment Agency of the City of Montebello ("**Agency**") and the City of Montebello ("**City**") that occurred prior to the dissolution of the Agency, in compliance with the direction / recommendation of the State Controller's Office ("**SCO**").

SUMMARY

As discussed during the November 6, 2013 Montebello Oversight Board ("**Oversight Board**") meeting, the SCO recently issued draft findings in connection its review of Agency transactions occurring between January 1, 2011, and January 31, 2012. (Staff Report Attachment "1", page 0001 (hereinafter simply "SRA 1:1".) Three (3) transactions have been flagged as "unauthorized" by the SCO, and it intends to demand they be reversed; provided the SCO has alternatively recommended such transactions be approved by the Oversight Board. Though the Montebello Successor Agency ("**Successor Agency**") disputes the SCO's findings, it desires to expeditiously resolve this matter and save the staff time and resources attendant with a continuing dispute; including potential litigation.

As such, in accordance with the SCO's recommendation and in dispute resolution efforts, the Successor Agency requests the Oversight Board approve the transactions described herein.

BACKGROUND

On November 6, 2013, a public Oversight Board study session was held, at which Successor Agency staff provided a briefing on the matters discussed herein, and Oversight Board members were provided an opportunity to ask clarifying questions and request further documentation. The following includes relevant information from the staff report from the November 6 study session, and is augmented in efforts to address the questions posed and documents requested by the Oversight Board.

A) The State Controller's Audit Authority

The Dissolution Act (Assembly Bill ("**AB**") 1x26 as amended by AB 1484) requires the SCO complete two (2) reviews / audits of transactions involving redevelopment agencies ("**RDA**"). The first review, at issue here, requires the SCO to determine whether an asset transfer

between a RDA and its sponsoring city occurred after January 1, 2011. (§ 34167.5.¹) If a transfer did occur, and the recipient city is not contractually committed to a third party for the expenditure or encumbrance of those assets, to the extent not prohibited by state and federal law the SCO must order the available assets returned to the successor agency. (§ 34167.5.) Upon receipt of such an order, the city must, as soon as practicable, reverse the transfer and return the applicable assets to the successor agency. (*Ibid.*)

SCO reviews are separate and distinct from the “due diligence reviews” (“**DDR**”) previously completed by the Successor Agency, and reviewed / approved by the Oversight Board and the Department of Finance (“**Finance**”). Like the SCO reviews described above, the DDRs analyzed transactions occurring after January 1, 2011 to determine whether, *inter alia*, any unauthorized transactions between a RDA and its sponsoring city occurred. In that sense, the SCO reviews and the DDR overlap.

B) Pertinent Agency – City Transactions

The Agency and City engaged in a several transactions prior to the former’s dissolution that are relevant to the issues discussed herein.

1) Agency’s Issuance and Redemption of the Montebello Economic Revitalization Project 1993 Tax Allocation Bonds

On June 30, 1993, the Agency issued the Montebello Economic Revitalization Project 1993 Tax Allocation Bonds (the “**Bonds**”) in the amount of \$4,757,015. (SRA 2:0002-8.) The Bonds enabled the Agency to repay certain loans, advances, and indebtedness issued by the City in conjunction with the redevelopment project. (SRA 2:0005.) The Bonds were marketed on the open market without success, and were therefore purchased by the City. They were scheduled to mature on June 1, 2012,² but were subject to early redemption on any date at a price equal to the then-principal balance plus accrued interest. (SRA 2:0002; 2:0006; see also SRA 3:0023.)

On December 8, 2010, the City called the Bonds pursuant to its redemption right, and the Agency approved the requisite redemption payment of \$5,042,436 (“**Redemption Payment**”). (SRA 4:0056-57; SRA 5:0058.) Because of the intervening holidays, the Redemption Payment was not processed until January 4, 2011. (SRA 6:0059.) The Redemption Payment saved the Agency \$856,260 in debt service payments it otherwise would have paid had the Bonds fully matured. (SRA 2:008.)

2) The Tax and Revenue Anticipation Note (the “TRAN”)

On June 14, 2010 the Agency and City executed a “Loan Agreement” by which the Agency loaned \$8,000,000 for the City’s use in paying and maintaining essential services and operations benefiting the Agency during a period of revenue shortfall. (SRA 7:0061-63.) On September 22, 2010, the Agency and City executed an “Amended and Restated Loan Agreement” (the “**TRAN**”) under authority of Government Code § 53850 *et seq.* (SRA 8:0064-67.) The TRAN superseded the Loan Agreement in its entirety, and increased the City’s “line of credit” to \$19.3 million. (SRA 8:0065-66.) During the life of the TRAN, the City borrowed a total of \$16,863,162.14. During the November 6 study session, Oversight Board members requested

¹ All statutory references herein are to California’s Health & Safety Code.

² During the November 6, 2013 study session, the Oversight Board requested that this full maturity date be confirmed. The cover page of the offering memorandum indicates the bonds become due on June 1, 2012 (SAR 2:0002), but according to the debt service schedule, the last payment appears to have been due on December 1, 2012 (SRA 2:0008).

records of the Agency-City transfers under the TRAN. Such records are provided herewith at Attachment 31, page 0391.

3) City's Repayment of the TRAN

In 2000, the City and the Montebello Public Improvement Corporation issued the 2000 Certificates of Participation ("**COPs**") to fund certain capital improvements of benefit to the Agency's project areas.³ (SRA 9:0068-0197.) Simultaneous with the COPs issuance, the City and Agency executed a Reimbursement Agreement, pursuant to which the Agency pledged to satisfy the City's payment obligations under the COPs in consideration for the project's redevelopment benefits. (SRA 10:0196-209.)

Debt service on the COPs is approximately \$1.3 million annually through the year 2026 (SRA 9:0104), and the Agency's payment of such amounts under the Reimbursement Agreement has been recognized by the Oversight Board and Finance as an "enforceable obligation." (SRA 11:0210; SRA 12:0211-214.)

On May 11, 2011, the City and Agency approved a "Prepayment and Partial Satisfaction Agreement" ("**Prepayment Agreement**"), under which the Agency prepaid \$17,462,276 of its future payment obligations under the Reimbursement Agreements; an amount equal to the amortization of the COPs payments between November 1, 2014 and November 1, 2026. (SRA 13:0215-218.) The City accepted the prepayment at the discounted present-day value⁴ of \$13,487,438 to offset amounts it owed the Agency under the TRAN. (SRA 13:0217.)

During the November 6 study session, Oversight Board members requested further documentation evidencing this "present day" calculation. Such is provided at Attachment 29, page 0389 of the documents submitted herewith.

On June 2, 2011, the City repaid the remaining \$3,375,724.14 TRAN balance by way of a cash transfer in that amount. (SRA 14:0219.)

The Prepayment Agreement has been reviewed and validated by various independent parties. It was finalized under the direction and supervision of the special bond counsel, Fulbright & Jawarski, LLP. (SRA 15:0223-224.) In addition, the legality of the TRAN was challenged in a citizens' suit, *Sevacherian v. All Persons*, which was dismissed in favor of the City and Agency when the Court found the TRAN had been repaid; in part by the Prepayment Agreement. (SRA 16:0225-0256 [Complaint]; SRA 17:0257-278 [City's Motion for Judgment on the Pleadings]; SRA 18:0279-0297 [Plaintiff's Opposition to MJP]; SRA 19:0298-306 [City's Reply re MJP]; SRA 20:0309-310 [Judgment].) Finally, the Prepayment Agreement was not questioned in the Successor Agency's "all other fund" DDR, which the Oversight Board and Finance reviewed and approved. (SRA 21:0327 [All Other Fund DDR]; SRA 22:0344-347 [Finance DDR approval ltr].)

As a result of the Prepayment Agreement, the Agency's obligation under the Reimbursement Agreement is scheduled to expire in November 2014; at which point the City will assume the COPs payments.

³ More specifically, the 2000 COPs were first to refinance a 1990 COPs issuance whose proceeds were used for capital improvements benefiting the Agency's project areas.

⁴ This discount was equal to sixty-seven percent (67%) of the of the Agency's payment obligations, based on the Internal Revenue Service Applicable Federal Rate as of the date of the transaction at 4.19%.

4) Housing Assets Transferred to the City as “Housing Successor”

On January 24, 2012, the City of Montebello elected to serve as the “housing successor” to the Agency under authority of the Dissolution Act. (§ 34176(a)(1); SRA 23:0348-349.) Upon the Agency’s dissolution, all housing-related powers, rights, obligations, and assets of the Agency were transferred the City as “**Housing Successor.**” (§ 34176(a)(1) [If a city elects to serve as housing successor, “all rights, powers, duties, obligations, and housing assets...shall be transferred to the city...”]) The total value of housing-related assets transferred to the Housing Successor on February 1, 2012 was \$22,205,148; as such were indicated in the “due diligence review” completed for the Agency’s “low-and-moderate income housing fund” (“**LMIHF**”) (SRA 24:0361):

<u>Type of Asset</u>	<u>Amount / Value</u>
Cash	\$ 11,220,290
Cash with Fiscal Agent	\$ 3,651
Due from other funds	\$ 8,956,665
Land held for resale	\$ 2,040,830
Machinery and equipment	\$ 27,225
<u>TOTAL</u>	\$ 22,248,662

On December 20, 2012, the Successor Agency remitted \$8,719,322 to the Los Angeles County Auditor-Controller in compliance with Finance’s LMIHF DDR determination. (SRA 25:0373; SRA 26:0375.) The remaining \$2,504,620 in LMIHF cash was expended by the Successor Agency in debt service payments during the ROPS III payment period (“**ROPS III Bond Payment**”). (SRA 11:0210.) This payment was approved by the Oversight Board and Finance. (SRA 12:0211-214.)

On July 31, 2012, the Housing Successor submitted a “housing asset list” to Finance for its review (as required by the Dissolution Act), listing those assets which had been transferred to the Housing Successor. (§ 34176(a)(2); SRA 27:0379-386.) On September 27, 2012, Finance issued its “housing asset determination,” which approved the Housing Successor’s retention of the following:

<u>Type of Asset</u>	<u>Amount / Value</u>
Due from other funds (LMIHF deferral)	\$8,956,665
Real Property (Single Family Dwelling – APN 5267-008-900)	\$366,230
Machinery and equipment	\$27,225
<u>TOTAL</u>	\$9,350,120

(See, SRA 28:0387-388.) Finance rejected the transfer of several real properties to the Housing Successor valued at \$1,674,600 for lack of sufficient documentation. (*Ibid.*) At the November 6, study session, Oversight Board members requested a site map of the Real Property at issue so as to better understand their nature. This parcel map is included in documents submitted herewith at Attachment 30, page 0390.

C. The SCO's Section 34167.5 Review – Initial Findings

The Successor Agency recently received the SCO's initial findings relating to its review under Health & Safety Code section 34167.5 ("**Initial Findings**"). (SRA 1:0001.) The Initial Findings were provided to the Successor Agency during an "exit conference" to allow staff an opportunity to respond before publication of the Draft Audit. The Initial Findings flagged the following three (3) transactions between the Agency and the City as "unauthorized":

- 1) The Redemption Payment;
- 2) The Prepayment Agreement; and
- 3) The transfer of \$13,529,340 in housing assets to the Housing Successor.

As reflected in the Initial Findings, the SCO intends to demand these transactions be reversed; provided that, if the Oversight Board approves them, the transactions will be deemed valid.

DISCUSSION

Though the Successor Agency disagrees with the SCO's Initial Findings, it desires to efficiently resolve these issues. Prompt resolution will further the Dissolution Act's goal of expeditiously resolving the affairs of the Agency, save staff time and resources attendant with continuing to dispute the SCO's findings (including possible litigation), and will remove any perceived "cloud" on Successor Agency finances.

To that end, the Successor Agency hereby requests Oversight Board approval of the three (3) transactions questioned by the SCO and outlined above. Each of the transactions is summarized individually below.

A. The Successor Agency Requests The Oversight Board Approve the Housing Asset Transfers

The SCO questioned \$13,529,340 in housing assets transferred from the Successor Agency to the Housing Successor on February 1, 2012, because the transfers were not first approved by the Oversight Board. The SCO's finding is based on Health & Safety Code section 34181(c), which requires oversight boards to "direct" successor agencies to transfer housing assets to the applicable "housing successor."

The housing assets at issue are segregable into the following four (4) categories:

- 1) \$8,956,665 in Deferrals Owed to the LMIHF ("**LMIHF Deferral**");
- 2) \$27,225 in Machinery & Equipment ("**Equipment**");
- 3) \$2,040,830 in Real Property ("**Real Property**"); and
- 4) \$2,504,620 in LMIHF Cash ("**Housing Cash**").

With regard to the LMIHF Deferral and Equipment, Finance has already approved such as "housing assets" via its determination on the "Housing Asset List" in September 2012. As such, the Oversight Board's approval of these transfers will be consistent with determinations already made by Finance.

As to the Real Property, Finance approved a single parcel (APN 5267-008-900) valued at \$366,230 via the Housing Asset List, but denied the remainder for lack of sufficient documentation. Since this denial, the Successor Agency has located further financial records

showing the parcels were purchased with LMIHF. Documentation evidencing this is set forth in Attachment 33, pages 0396 to 409. With this additional information, an Oversight Board directive to the transfer of remaining Real Properties to the Housing Successor is appropriate.

Finally with respect to the Housing Cash, these assets were used by the Successor Agency to make payments on bond debt service during ROPS III; a payment already approved by the Oversight Board and Finance. (SRA 11:0210; SRA 12:0211-214.) The Oversight Board's reinforcement of this approval for the benefit of the SCO is appropriate. At the November 6 study session, the Oversight Board requested financial records evidencing that the ROPS III payments were actually made with LMIHF. Such documentation is provided herewith as Attachment 32, pages 0392 - 0396.

Based on the foregoing, the Successor Agency hereby requests the Oversight Board adopt a Resolution approving the February 1, 2012, transfer of \$11,024,720 in "Housing Assets" from the Successor Agency to the Housing Successor, and reinforcing its approval of \$2,504,620 in LMIHF cash expenditures on ROPS III towards bond indebtedness, pursuant to Health & Safety Code section 34181(c).

B. The Successor Agency Requests the Oversight Board Approve the Redemption Payment

The SCO also has questioned the \$5 million Redemption Payment on the Montebello Economic Revitalization Project 1993 Tax Allocation Bonds. This determination is based on the SCO's opinion that the Agency was not allowed to transfer cash to the City after January 1, 2011. (SRA 1:0001.)

In submitting this matter for Oversight Board approval, the Successor Agency notes the transaction was completed long before enactment of AB 1x26 and the eventual dissolution of the Agency, and thus was clearly not an attempt to improperly encumber Agency assets for the benefit of the City. Indeed, the Bond was issued in 1993 and would have matured on June 1, 2012, with a final payment due December 2012, regardless of the early Redemption Payment.

Furthermore, though the Dissolution Act generally voided agreements and/or arrangements between a RDA and its sponsoring City (§ 34178), this likely does not extend to RDA bond issuances that were legitimately purchased by cities on the open market. Indeed a reasonable interpretation of the Dissolution Act is that all bonds – regardless of whether they were purchased by cities or by independent investors – are considered "enforceable obligations" which RDAs were authorized to perform. (§§ 34167(d)(1), 34171(d)(1)(A) [listing bonds as enforceable obligations].) In that sense, the Redemption Payment is likely consistent with the Dissolution Act's mandate that "enforceable obligations" be performed. (See §§ 34167(f) [nothing in AB 1x26 intended to impair performance of enforceable obligations], 34169(a) [RDAs must continue to perform enforceable obligations], 34175(a) [enforceable obligations are to be honored].)

With this in mind, the Oversight Board's approval of the Redemption Payment is appropriate. It would be consistent with a reasonable interpretation of the Dissolution Act, and in furtherance of an "enforceable obligation"; the Bonds. Relatedly, the Dissolution Act authorizes the Oversight Board to approve a request by a Successor Agency to "enter into an agreement with the city...that formed the redevelopment agency it is succeeding." (§ 34180(h).) Here, the Oversight Board's approval likely falls within this authority, as the approval would uphold an agreement previously performed between the Agency and City, and reaffirm its enforceability on the Successor Agency. In addition, the Oversight Board has authority to direct the disposal of Agency assets. (§ 34181(a).) Approval of the Redemption Payment would reinforce that Agency assets were "disposed of" in payment for the Bonds.

Finally, the Successor Agency notes transaction benefits the taxing entities, in that ***the Redemption Payment saved the Agency \$856,260 in debt service payments that would have been due had the Bonds fully matured.*** If the Redemption Payment is reversed, as the SCO suggests, the entire Bond balance will be reinstated (either immediately or upon issuance of a Finding of Completion to the Successor Agency) and included on subsequent Recognized Obligation Payment Schedules; resulting in a net-loss to taxing entities. (See § 34191.4 [reinstating city-RDA loan agreements upon receipt of finding of completion].) As such, approval of the Redemption Payment benefits the taxing entities.

Based upon the foregoing, the Successor Agency hereby requests the Oversight Board adopt a Resolution approving the January 4, 2011 Redemption Payment from the Agency to the City, pursuant to Health & Safety Code Sections 34180(h) and 34181(a).

C. The Oversight Board May Retroactively Approve the Prepayment Agreement

The SCO questioned the Prepayment Agreement based on its understanding that the Agency was not authorized to transfer assets to the City after January 1, 2011.

Notably, the Prepayment Agreement was not flagged in the DDR (which reviewed Agency-City transactions during the identical time period), it was entered into with the blessing of special bond counsel, and the transaction was validated by a Los Angeles Superior Court judge in the *Sevacherian v. All Persons* action. In line with these independent analyses, the Successor Agency believes the Oversight Board's approval of the transaction would be consistent with past Finance determinations, and the judgment in the *Sevacherian v. All Persons* case.

Furthermore, unwinding the Prepayment Agreement will reinstate the Agency's payment obligations under the Reimbursement Agreements through the year 2026, ***resulting in a net loss of approximately \$4 million dollars to the taxing entities over the life of the 2000 COPs***, and extending the long-term debt obligations of the Agency. Such results are not advantageous to the Successor Agency and the taxing entities.

As with the Redemption Payment, the Oversight Board has authority to approve the transaction: the approval would reinforce its validity on the Successor Agency (§ 34180(h)), dispose of Agency assets towards the performance of an enforceable obligation, *i.e.* the Reimbursement Agreement (§ 34181(a)), and result in approximately \$4 million in savings to the taxing entities.

For these reasons, the Successor Agency requests the Oversight Board adopt a Resolution approving the May 11, 2011 Prepayment Agreement between the Agency and City, pursuant to Health & Safety Code sections 34180(h) and 34181(a).

RECOMMENDATION / CONCLUSION

It is recommended the Oversight Board adopt the following Resolutions approving the transfers questioned by the State Controller's Office:

- A Resolution of the Montebello Oversight Board Approving The February 1, 2012, Transfer of \$11,024,720 in "Housing Assets" From the Montebello Successor Agency to the City of Montebello as Housing Successor, and Reinforcing Its Approval of \$2,504,620 in LMIHF Cash Expenditures On ROPS III Towards Housing Bond Indebtedness;

- A Resolution of the Montebello Oversight Board Approving the January 4, 2011 Redemption Payment Relating To The Montebello Economic Revitalization Project 1993 Tax Allocation Bonds, Made From the Former Community Redevelopment Agency of the City of Montebello, to the City of Montebello; and
- A Resolution Approving the May 11, 2011, Prepayment Agreement and Partial Satisfaction Agreement between the former Community Agency of the City of Montebello and the City of Montebello

Public notice of these proposed Oversight Board actions has been published in compliance with Health & Safety Code section 34181(f). (SRA 34:0410.)